

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Establish
Policies and Cost Recovery Mechanisms for
Generation Procurement and Renewable
Resource Development

Rulemaking 01-10-024

ADMINISTRATIVE LAW JUDGE'S RULING

This ruling addresses the May 9, 2003 motion of Calpine Corporation (Calpine) and also the legal briefs filed in response to issues raised at the March 7, 2003 prehearing conference (PHC).

1. Calpine Motion

In its May 9 motion, Calpine requests the Commission provide expedited guidance and authority to San Diego Gas & Electric Company (SDG&E) to enable SDG&E to immediately address its resource needs for 2005, including expediting discussions with Calpine to secure an executed and approved long-term, cost-effective power purchase agreement (PPA) for the Otay Mesa Generating Project (Otay Mesa). Calpine asserts that Otay Mesa is the only highly efficient, dispatchable project realistically capable of satisfying SDG&E's 2005 on-system reliability needs. Further, it asserts that Otay Mesa's strategic location within SDG&E's service territory affords it the unique ability to provide SDG&E's ratepayers with a variety of reliability, environmental and economic benefits; specifically, it states Otay Mesa has the ability to potentially reduce SDG&E's Reliability Must-Run (RMR) costs by approximately \$50 million annually.

Calpine asserts that it has provided the Commission with a Term Sheet that should provide a sufficient basis on which to analyze and issue an order advising and authorizing SDG&E to develop a comprehensive PPA which builds on the key commercial terms identified in the Term Sheet, and finding that SDG&E's timely execution of such a PPA would be reasonable, prudent and in its ratepayers best interests. It states that in order for the desired completion and operation of Otay Mesa by 2005, there needs to be execution of a PPA by summer 2003.

The California Independent System Operator (California ISO), the agency that is responsible for preserving and protecting the reliability of the grid in the control area that includes the service territory of San Diego Gas & Electric Company, submitted a letter in support of the development of the Otay Mesa project. The letter appears as Exhibit A to Calpine's Motion. In the letter, California ISO President, Terry Winter, identifies the City and County of San Diego as "an area of concern to the California ISO." The letter states that:

"The construction of the Otay-Mesa Generation Project will substantially improve the reliability of service to the city of San Diego and surrounding areas and would help address concerns over statewide resource adequacy. It will prevent resource shortages, which otherwise might occur in the San Diego area in the next two-three years. Addition of this plant will also help reduce the cost of energy and thus be beneficial to California consumers. Another benefit of the Otay-Mesa power plant is that it will provide much needed voltage support to the San Diego area."

The comments of the California Consumer Power and Conservation Financing Authority (Power Authority) also stress the reliability-enhancing virtues of the Otay Mesa project. The Comments quote the California ISO letter of Mr. Winter and stress that the Power Authority and the California Energy Commission have identified the need for electricity capacity and energy to be brought on line on time, in order to insure system reliability. Specifically, David Freeman declares: "The need for Otay Mesa is to relieve the serious electric reliability concerns in the San Diego area."

Save Southwest Riverside County (SSRC) also filed comments in support of Calpine's motion, citing extensively from Decision (D.) 02-12-066, SDG&E's Valley-Rainbow transmission proceeding.

Comments opposing Calpine's motion filed by SDG&E, Sempra Energy Resources (SER), and Dynergy Marketing and Trade (Dynergy). SDG&E states it issued a Request for Proposals (RFP) to address resource needs beginning in 2005 on May 16, 2003 and that the Commission should look at the broad range of available resource options this competitive process may provide before considering Calpine's request. Further, it states no record has been established in this proceeding to buttress Calpine's assertions. Therefore, it urges the Commission to reject Calpine's motion.

SER asserts that the Calpine motion relies on factually incorrect allegations, specifically that a contract for the 2005 68MW needs to be in place by July 2003 and that Otay Mesa is the only project realistically capable of satisfying SDG&E's on-system reliability needs. Further, SER asserts that because of its proposed location, Otay Mesa is subject to SDG&E's transmission import constraints and, as a result, is incapable of enhancing the load-serving capability of, or providing RMR support to, the SDG&E transmission grid until the

transmission import constraints are removed. Dynergy states that as a matter of policy, the Commission should not compel parties to enter into agreement like the one proposed by Calpine and, in particular, should not force one party to agree at the request of the other party.

I find that Calpine's motion, and the comments filed in support of the motion, provide sufficient grounds for the Commission to provide the opportunity for expedited consideration of its request in the upcoming hearings if the record evidence establishes the claims made by Calpine. SDG&E's procurement plan will be considered at the beginning of the hearings and an opportunity for oral argument on the need for expedited consideration of Otay Mesa may be afforded all parties directly following the testimony. An expedited procedural process for this issue will be discussed in more detail at the July 9, 2003 PHC.

Calpine should provide testimony on June 16, 2003 supporting its factual claims and entering its Term Sheet into the record if it wants the Commission to give the details the Term Sheet contains consideration. Likewise, SER should provide testimony on June 16, 2003 supporting its assertions of Calpine's factually incorrect allegations and other parties may address the merits of Calpine's request in their testimony.

I also take official notice for this record of D.02-12-066 and the record underlying that decision. I note that in the hearings leading to D.02-12-066, no party raised the issue that because of its proposed location, Otay Mesa is subject to SDG&E's transmission import constraints. SDG&E should in its July 7, 2003 rebuttal testimony provide as much information as it can on whether its RFP process resulted in viable alternative options to meet its procurement needs.

2. Briefing Issues

At the March 9, PHC, I requested parties to file legal briefs on four issues in order to minimize the extent to which these issues will need to be addressed during evidentiary hearings. Based on a review of these briefs, I do not see the need to issue a separate decision prior to the start of hearings, although additional rulings may follow. I address one issue here, because I see the need in the upcoming hearings to augment the record with factual and policy testimony. This issue is how adequate planning reserves should be provided for direct access customers.

In response to the question I raised at the PHC of what is the utilities' legal obligation to provide reserve capacity for direct access customers, community aggregators, and distributed and self-generation customers, a number of parties submitted comments. While almost all parties stated that ensuring adequate reserves was an important issue, parties disagreed over the appropriate methods to achieve this goal. Several parties believed that either the FERC or the California ISO should have this responsibility. This approach would conflict with the Commission's officially adopted position, filed in comments before FERC, that resource procurement is fundamentally an issue of state, not federal concern, and that imposition of a federal resource adequacy requirement would infringe upon the state's sovereignty. Even FERC, in its recently released "White Paper" states that it would:

Allow an RTO/ISO to "implement a resource adequacy program only where a state (or states) asks it to do so, or where a state does not act."..."States may decide to ensure resource adequacy through state imposed requirements on utilities serving load within the region...

Similarly, the California ISO, has recognized that resource procurement is primarily a state function.¹

Several parties recognize that the state is an appropriate entity to address reserve issues. (TURN, California ISO). SDG&E and Edison both note that the Commission could impose reserve requirements upon load-serving entities (LSEs) under the requirements of PU Code 394. This code section allows the Commission to determine that energy service providers (ESPs) demonstrate “technical and operational reliability” and “financial viability.” As Sempra states, “apart from the law and theory, the State as a matter of public policy may determine that system reliability requires that load-serving entities (LSEs) meet a resource adequacy test, inclusive of supply reserves.”

Several potential approaches to addressing reserves were identified in comments. These include:

The utilities acquire reserves for ESPs and/or direct access customers;

The utilities acquire reserves for ESPs and/or direct access customers and charges them for this service; and,

ESPs, are required by the Commission to acquire necessary reserves.

It is also possible that there could be combinations of the above options. (For example, a utility would acquire reserves for an ESP only if the ESP failed to acquire sufficient reserves on its own.)

¹ On the issue of the provisional 15% reserve level adopted in D.02-10-062, I request the CPA in its June 16, 2003 testimony provide a list of the comments it has received in the last year on the level of reserve margins so that the Commission can take official notice of these comments in this proceeding.

Without pre-judging either the legality or desirability of these approaches, the Commission is interested in gaining a better understanding of how each of the above three options could be implemented, implementation details that need to be addressed , and public policy considerations associated with each option. In crafting these proposals we urge parties to address the concerns of parties that any such requirements be carried out in a neutral and non-discriminatory manner. To provide a comprehensive record on this issue, I request the respondent utilities and other interested parties to serve supplemental testimony on these three options, to include implementation details, on June 16, 2003.

Therefore, **IT IS RULED:**

1. Calpine's May 9, 2003 motion for expedited guidance and authority, and the comments filed in support of the motion, provide sufficient grounds for the Commission to provide the opportunity for expedited consideration of Calpine's request in the upcoming hearings if the record evidence establishes the claims made.
2. Calpine shall provide testimony on June 16, 2003 supporting its factual claims.
3. All interested parties shall provide testimony on June 16, 2003 of any additional facts the Commission should consider in regards to Calpine's motion.
4. SDG&E shall provide in its July 7, 2003 rebuttal testimony as much information as it can on whether its Request for Proposals process resulted in viable alternative options to Otay Mesa.
5. Official notice of the record leading to D.02-12-066 is taken.
6. The petitions to intervene of Dynergy Marketing and Trade, InterGen, N.V., Save Southwest Riverside County, and Sempra Energy Resources are

granted. In addition, for good cause shown, the May 12, 2003 petition to intervene of Peabody Western Coal Company is granted.

7. The respondent utilities should serve supplemental testimony on June 16, 2003 on the three options listed above for providing adequate planning reserves for direct access customers. Other interested parties are encouraged to address this issue in their testimony.

Dated May 30, 2003, at San Francisco, California.

/s/ CHRISTINE M. WALWYN

Christine M. Walwyn
Administrative Law Judge

CERTIFICATE OF SERVICE

I certify that I have by mail this day served a true copy of the original attached Administrative Law Judge's Ruling on all parties of record in this proceeding or their attorneys of record.

Dated May 30, 2003, at San Francisco, California.

/s/ ELIZABETH LEWIS

Elizabeth Lewis

N O T I C E

Parties should notify the Process Office, Public Utilities Commission, 505 Van Ness Avenue, Room 2000, San Francisco, CA 94102, of any change of address to insure that they continue to receive documents. You must indicate the proceeding number on the service list on which your name appears.

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If specialized accommodations for the disabled are needed, e.g., sign language interpreters, those making the arrangements must call the Public Advisor at (415) 703-2074, TTY 1-866-836-7825 or (415) 703-5282 at least three working days in advance of the event.